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The Court of Appeal Judgment in the Adler Restructuring Plan: Pari Passu Is Back!

By Gregory Petrick, Bevis Metcalfe, Simon Walsh and William Sugden*

In this article, the authors examine a decision by the Court of Appeal of England and Wales to overturn the Adler Group restructuring plan.

The Court of Appeal of England and Wales has unanimously overturned the High Court of Justice in London's decision to sanction the Adler Group's restructuring plan, following a successful challenge from an ad hoc committee of noteholders (the AHG).[1] The judgment is the first time a Part 26A restructuring plan has been considered by the Court of Appeal since the introduction of the provision in 2020.

Part 26A restructuring plans empower an English Court to order a compromise or arrangement of debt obligations, even if there is one or more dissenting class of creditors (a power referred to as "cross-class cram-down"). The court may do this if, inter alia, it is satisfied that none of the members of the dissenting class or classes would be any "worse off" than they would be were the restructuring plan not to be sanctioned by the court.

BACKGROUND

In April 2023, Leech J sanctioned Adler's restructuring plan.[2] The plan sought to avoid an imminent insolvency of the Group, in part by introducing €937.5m of new money funding and allowing Adler to pursue a solvent wind down of its business. The plan involved the extension of the maturity of the earliest maturing notes (the 2024s) and provided those noteholders with priority in security over the other noteholders in the security package. The plan was opposed by the AHG, who held notes maturing in 2029 (being the final series of notes to mature), and who argued that the plan unfairly deprived them of the pari passu treatment which they would otherwise receive in a German insolvency of the Group, which was accepted as the "relevant alternative" for purposes of Part 26A.

The High Court had sanctioned the Group's proposed restructuring plan, finding that the plan did not violate the pari passu principle despite providing

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1 Re AGPS Bondco Plc [2024] EWCA Civ 24.

2 Re AGPS Bondco Plc [2023] EWHC 916 (Ch).

for differential treatment to otherwise pari passu creditors. One of the AHG's arguments was that the plan – which they termed a "liquidation plan" – infringed the pari passu principle because it maintained the time subordination of the 2029 Notes and further subordinated it with new money. Crucially however, Leech J found that it was likely creditors would be paid in full under the plan (based on the evidence presented to the court) and as such a pari passu distribution would not even become relevant. The plan became effective immediately after the court had sanctioned it.

THE COURT OF APPEAL JUDGMENT

The Pari Passu Principle

The key reason the Court of Appeal overturned the High Court's decision was that the plan violated the pari passu principle. The pari passu rule is a fundamental principle of insolvency law (tracing its roots back to Section 2 of Henry VIII's Statute of Bankrupts 1543). It provides that all unsecured creditors must share equally any available assets of the company in proportion to the debts due to each creditor.

Why Did the Plan Violate the Pari Passu Principle

As noted above, a feature of the sanctioned plan was that it maintained the original chronological maturity dates of the different series of notes (albeit with the earliest 2024 notes being extended to 2025). The longest dated debt instruments were the 2029 notes held by the AHG. Understandably, the holders of the 2029 notes objected to this feature of the plan due to concerns that there was a risk they would not be repaid given the financial state of the Adler Group and the nature of the "liquidation plan," which, by its nature, would reduce the value of assets available to creditors over time. Although the plan was supported by valuation evidence the court found that there was a risk that the Group might fail to realize the sums forecast in these reports. Thus there was a risk the Group might run out of money from realizations and be unable to meet the obligations under the 2029 notes. Lord Justice Snowden neatly summarized the issue as follows:

> . . . adherence to the principle of pari passu distribution of the Group's assets would have eliminated that risk by proportionate distributions being made rateably to all Noteholders from time to time. Put shortly, sequential payments to creditors from a potentially inadequate common fund of money are not the same thing as a rateable distribution

of that fund.[3]

That said – the court acknowledged that a departure from the principle of pari passu distribution of the benefits of the restructuring can be permitted if there is a good or proper reason for that departure. We offer some insight into what this might mean below.

WHERE TO FROM HERE?

The Court of Appeal's decision to reverse the plan leaves many wondering what happens now? The Group has already commenced implementing the restructuring that had been approved by the High Court approximately nine months ago.

On appeal it was submitted by the Group that the court should be slow to interfere with the High Court's judgment given that implementation of the plan was well under way. However, ultimately it was accepted by the Group that if the High Court had been wrong in exercising its discretion to sanction the plan that the judgment cannot stand and the appeal should be allowed. The Group has stated that it intends to continue with its restructuring as planned and that "the terms and conditions of the bonds remain valid regardless of the decision."[4]

From a practical point of view looking forward, the court suggested that where an appeal of a plan is contemplated, parties should consider applying for implementation of the restructuring plan to be stayed until after permission to appeal is determined (though many potential applicant groups in a dissenting class might be dissuaded from so doing by the need to provide a cross-undertaking in damages).

OTHER KEY TAKEAWAYS FROM THE JUDGMENT

When Can a Restructuring Plan Depart from the Pari Passu Principle?

It seems that a plan can depart from the pari passu principle for a good or proper reason. Practitioners will no doubt be querying what amounts to a "good" or "proper" reason. The Court of Appeal declined to provide an exhaustive list of criteria that might qualify, considering that such an exercise would neither be possible nor advisable.[5] However the court did say that a

[3] [2024] EWCA Civ 24, per Snowden LJ at 193.

[4] https://www.ft.com/content/82d23ce7-3aeb-4052-a8ff-a08c5f69fbe4.

[5] [2024] EWCA Civ 24 per Snowden LJ at 166.

departure could be justified if a creditor provided new money to facilitate a restructuring. In this scenario the creditor should be entitled to receive full payment of that new money under a plan in priority to the pre-existing creditors.[6]

Did the Priority Given to the 2024 Notes by the Enhanced Security Violate the Pari Passu Principle?

The plan gave the 2024 noteholders enhanced security in the form of priority over the other series of notes. The additional security was offered as a quid pro quo for the 2024 noteholders deferring their maturity date. While the Court of Appeal concluded that offering this enhancement to the 2024 noteholders did depart from the pari passu principle,[7] the maturity deferral could be a good reason or proper basis for such a deviation. As such, this issue was not one that would have led to the court allowing the appeal.[8]

Discretion to Sanction a Plan – What Test Applies?

The judgment provides guidance on the principles applicable to exercise of the court's discretion to sanction a restructuring plan in the context of a "cross class cram down."

The High Court had adopted a "rationality test" – derived from scheme cases under Part 26. This test asked whether it would be fair to impose the scheme upon the dissenting members of the class, based only upon a rationality check on the commercial judgment of the majority of creditors approving the plan. Key to this test is a presumption that the interests of members of a creditor class were sufficiently similar, based upon their rights.

However, the Court of Appeal disagreed finding that applying the "rationality test" from scheme cases under Part 26 was insufficient in the context of a Part 26A restructuring plan, and also that the court could not consider whether the plan was the only one that could have been advanced or whether a better plan could have been proposed by the company. Instead, the court found that there can be no commonality of commercial interests between the assenting and dissenting classes (that being the very reason that creditors have been placed in different classes). As such, a vote in favor of a plan (even an overwhelming)

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[6] [2024] EWCA Civ 24 per Snowden LJ at 168.

[7] [2024] EWCA Civ 24 per Snowden LJ at 226.

[8] [2024] EWCA Civ 24 per Snowden LJ at 231.

one,[9] did not mean that it was fair to impose that plan on the dissenting class given the approving and dissenting classes were in materially different commercial positions.

The Court of Appeal instead confirmed that the court should consider the horizontal comparator test. This test, developed in the context of company voluntary arrangements requires a comparison of "the position of the class in question with the position of other creditors or classes of creditors (or members) if the restructuring goes ahead."[10] That comparison asks how different classes of creditor should be treated relative to each other in the relevant alternative; and investigates whether their relative treatment under the plan is consistent with that relevant alternative, or whether there is differential treatment. If there is differential treatment, a "good reason" must exist for such differentiation and it must be justified on a "proper basis."

The Court of Appeal found that there was insufficient justification to sanction differing treatment of creditors between the relative alternative (being the German liquidation where the AHG would be in the normal pari passu position) and the restructuring plan, noting that the "parties could easily have produced a fairer plan that eliminated the different treatment of the different series of Notes by agreeing to harmonise the dates."[11]

What Is the Best Plan?

In applying the horizontal comparison test the court will be required to consider whether the proposed plan is the "best" plan, and whether a different formulation of the plan could be "fairer." This is a significant move away from the scheme cases where the court was not required to consider if a scheme could be "fairer" but only whether it was "fair."

Important Procedural Considerations for Future Plans

The Court of Appeal's judgment also highlighted some significant procedural considerations for companies proposing a restructuring plan. A particular issue of note in Adler was timing: Courts are increasingly moving towards larger time gaps between convening and sanctions hearings to allow for exchange by the parties of sufficient evidence to enable the court to make well-founded decisions

[9] Indeed, the total number of creditors who voted to approve the plan amounted to 84% of plan creditors across the six classes.

[10] [2024] EWCA Civ 24 per Snowden LJ at 149.

[11] [2024] EWCA Civ 24 per Snowden LJ at 203.

(particularly around valuations). The Court of Appeal made clear in no uncertain terms that, whilst genuine urgency can almost always be accommodated by the court, companies with a known impending maturity or liquidity event should not delay plan applications. Short shrift will be given to parties approaching the court with insufficient time (intentionally or not) for a fair court process, including exchange and testing of relevant valuation evidence, to be accommodated.

Can Shareholders Retain Equity?

It seems like it is perfectly acceptable for a restructuring plan to impose a haircut on creditors while allowing shareholders to retain equity without infringing pari passu. Ultimately, in an insolvency scenario shareholders would not be paid until creditors were paid in full. Thus it was not a departure from the pari passu principle for a plan to allow shareholders to retain an equity position. And further, following the view taken in *Virgin Active*,[12] it is a matter for those creditors that would be in-the-money in the relevant alternative that were accepting a compromise of their claims to decide whether to share any value that might flow from the restructuring by permitting shareholders to retain some or all of their equity in the restructured company.

Can Shareholders or Creditors Be "Zeroed"?

The AHG contended that, as the shareholders were adding nothing of commercial value and were not providing any new money the shareholders should not be permitted to share in any potential upside flowing from the plan. The corollary of this is that their shares should be cancelled or transferred to the plan creditors. The court did not accept this argument, offering a provisional view that there is no jurisdiction under Part 26A to "zero" (whether by cancelling or transferring) the shares in a debtor company for no consideration.[13]

Is the Issuer Substitution Technique in the Cross-Hairs?

The Group utilized the "Issuer Substitution" to engage the jurisdiction of the English restructuring plan. This involves incorporating an English incorporated company which assumes the group's debt and launches the restructuring proceedings. In this case, the English company was AGPS Bondco Plc. Prior to Adler this technique had been sanctioned at first instance in a number of

[12] [2021] EWHC 1246 (Ch).

[13] [2024] EWCA Civ 24 per Snowden LJ at 258.

decisions over the last few years.[14] However, Snowden LJ noted this technique had not been the subject of consideration at an appellate level. Ultimately the appeal did not consider the issuer substitution technique, but Snowden LJ made it clear in his written judgment that "for the avoidance of doubt, and without expressing a view one way or the other, I would wish to make it clear that the fact that this judgment does not deal with this issue should not be taken as an endorsement of the technique for future cases."[15] He had previously shown an eagerness to examine this technique.[16] The application of this technique therefore remains an open issue.

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[14] See e.g. Codere Finance (UK) Limited [2015] EWHC 3778 (Ch); Gategroup Guarantee Limited [2021] EWHC 776 (Ch).

[15] [2024] EWCA Civ 24 per Snowden LJ at 34.

[16] See e.g. Port Finance Investment Limited [2021] EWHC 387 at 58-75.